IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 113 of 1985

For Approval and Signature:

Hon'ble CHIEF JUSTICE MR DM DHARMADHIKARI
and
Hon'ble MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

1 & 2 Yes
3 to 5 No

GUJARAT AGRO OIL ENTERPRISES LTD.

Versus

COMMISSIONER OF INCOME-TAX

Appearance:
MR JP SHAH for Petitioner
MR AKIL QURESHI for MR MANISH R BHATT for Respondent No. 1

CORAM : CHIEF JUSTICE MR DM DHARMADHIKARI
and
MR.JUSTICE A.R.DAVE

Date of decision: 12/01/2001

JUDGEMENT

(Per : MR.JUSTICE A.R.DAVE)

At the instance of the assessee, the following question of law, arising out of the order dated 30.3.1984 passed by the Income Tax Appellate Tribunal, Ahmedabad Bench 'B' in I.T.A. No. 829/Ahd/1983, has been referred to this court for its opinion under the provisions of sec. 256(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act').

"Whether, on the facts and in the circumstances of the case, and on the basis of material placed before the Tribunal, the amount of legal fees of Rs. 80,850/- was expenditure wholly and exclusively incurred for the purpose of business and therefore allowable under section 37(1) of the Income-tax Act, 1961?"

2. We have heard learned advocate Shri J.P. Shah appearing for the assessee and learned advocate Shri Akil Qureshi appearing for the revenue.

3. The circumstances in which the question referred to hereinabove has arisen, in a nutshell, are as under:

4. The assessee, Gujarat Agro Oil Enterprises Ltd., is a subsidiary of Gujarat Agro Industries Corporation Ltd. The assessee company was appointed by the State of Gujarat as its agent for procurement, storage and distribution of edible oil. There was an allegation that the assessee company, its officers and one of its directors, Shri Narbheshanker N. Panesari, had indulged in some irregularities or illegalities in the matter of purchase of groundnut, groundnut seeds, groundnut oil, etc. In the circumstances, the State of Gujarat had appointed a one-man Commission of Justice J.M. Sheth under its Notification dated 16.12.1976 to make an inquiry and to ascertain whether Shri Panesari, one of the Directors of the company, who was also one of the members of a committee which was functioning for the assessee company, had exceeded his powers and whether the officers of the assessee company had deliberately connived at the actions of Shri Panesari and whether as a result of such actions, the government was put to loss. The Commission had also to enquire whether there was any carelessness or laxity in supervision and control on the part of the officers of the assessee company. It was also to be ascertained whether, in the matter of purchase of groundnut seeds and groundnut oil on behalf of the assessee company, Shri Panesari had exceeded his powers

and had acted without consulting or informing the assessee company.

5. In pursuance of appointment of the Commission, the assessee company had engaged an advocate to represent the assessee and by way of professional fees a sum of Rs. 80,850/- was paid to the advocate for assisting the Commission in the matter of ascertainment of facts. The said amount of fees was claimed as an expenditure under the provisions of sec. 37(1) of the Act.

6. The Assessing Officer did not allow the said expenditure and added the same in the income of the assessee company mainly on the ground that the said expenditure did not relate to the business of the assessee company and the said expenditure related to 1972-73, as the alleged irregularities and illegalities were committed during the said period. The Assessing Officer was also of the view that the assessee company had engaged an advocate so as to maintain reputation of the company and in that event the expenditure should have been treated as capital expenditure. Thus, the said amount was disallowed and was added in the income of the assessee.

7. Being aggrieved by the addition referred to hereinabove, the assessee company filed an appeal before the CIT (Appeals). It was submitted before the CIT (Appeals) that the advocate was engaged for appearing before the Commission and to assist the Commission. It was necessary to defend the assessee company and its officers as the allegations which had been levelled against the assessee company and its officers were baseless. It was necessary to incur the expenditure so as to protect the reputation of the company and to enhance the credibility of the assessee company so as to develop its business and, therefore, the expenditure was justified and was also allowable under the provisions of sec. 37(1) of the Act as it was incurred exclusively for the purpose of the assessee company's business. The CIT (Appeals) allowed the appeal and deleted the disallowance of the expenditure referred to hereinabove. The CIT (Appeals) was of the view that simply because the allegations levelled against the assessee company, its officers and its director pertained to transactions which had taken place in the past, they could not have been disallowed especially in view of the fact that the advocate was paid fees during the relevant assessment year and as the assessee company had incurred the expenditure for protecting its reputation, the said expenditure was allowable as business expenditure.

8. Being aggrieved by the order passed by the CIT (Appeals), the respondent filed an appeal before the Tribunal. After hearing the concerned parties, the Tribunal allowed the appeal by observing that the expenditure was not incurred for the purpose of business. According to the Tribunal, it was not necessary for the assessee company to engage an advocate especially when the Commission had an access to the entire record of the assessee company, which was a subsidiary company of a government corporation. The Tribunal was also of the view that the assessee company, which was a government company, should not have incurred expenditure to protect its employees especially when there were allegations against the officers with regard to commission of irregularities and illegalities. Thus, the Tribunal was of the view that the Assessing Officer had rightly disallowed the expenditure which was incurred by way of legal fees.

9. Looking to the facts stated hereinabove, this court has to opine whether the amount of legal fees which was paid by the assessee company to its advocate for representing its case and placing proper facts before the Commission was an allowable expenditure under the provisions of sec. 37(1) of the Act.

10. Learned Advocate Shri J.P. Shah appearing for the assessee company has mainly submitted that it was the duty of the assessee company to place correct facts before the Commission and for that purpose it was absolutely necessary for the assessee company to have services of a competent advocate. It was pointed out to us that certain serious allegations were levelled not only against one of the directors of the assessee company, but also against the assessee company and its officers. There were all chances that if the correct facts were not placed before the Commission, the Commission could have come to some incorrect conclusion which could have adversely affected the reputation and business of the assessee company. When the assessee company, its officers and its director had acted in good faith and for enhancement of the business of the assessee company without committing any fraud, illegality or irregularity, it was the duty of the assessee company to protect its employees and its director. In such a set of circumstances, if an employer spends any amount so as to place correct facts before the Commission and also to protect its rightful employees and director, by no stretch of imagination it can be said that the expenditure so incurred cannot be treated as business

expenditure.

11. It has been submitted by him that the State Government had appointed a High Court Judge as an inquiry Commission and the Commission had to look into the allegations which were civil in nature. He has submitted that even in cases where allegations levelled against the employees are criminal in nature, the expenditure incurred by the employer for defending its employees are treated as business expenditure and, therefore, there was no reason for the revenue to disallow the expenditure incurred by the assessee company.

12. It has been further submitted by him that if any expenditure is incurred for the purpose of protection of assets or goodwill of the company, the expenditure so incurred cannot be said to be capital expenditure. According to him, the expenditure was of revenue nature and the revenue ought to have allowed the same.

13. It has been submitted by the learned advocate appearing for the assessee company that normally the revenue should leave it to the assessee whether the assessee should incur a particular type of expenditure for the purpose of protection of its business or reputation. It is always for the businessman to use his prudence in the matter of incurring expenditure and it would not be just and proper on the part of the revenue to decide whether the expenditure incurred was just or unjust.

14. So as to substantiate the submissions made by him, he has relied upon judgments delivered in the following cases :

Ishwari Khetan Sugar Mills (P.) Ltd. v. CIT, 86 ITR 635

CIT v. H. Hirjee, 23 ITR 427

CIT v. Navsari Cotton & Silk Mills Ltd., 135 ITR 546

CIT v. Dhanrajgiri Raja Narasingirji, 91 ITR 544

CIT v. Ahmedabad Controlled Iron & Steel Reg. Stockholders Association Pvt. Ltd., 99 ITR 567

Rohtas Industries Ltd. v. CIT, 67 ITR 361

Maddi Venkataraman and Co. (P.) Ltd. v. CIT,

15. On the other hand, learned advocate Shri Akil Qureshi appearing for the revenue has tried to justify the action of the Assessing Officer and the reasons stated by the Assessing officer and the Tribunal to show that the expenditure incurred by the assessee company was rightly not allowed as business expenditure. It has been submitted by him that the Commission could have been supplied with the relevant material by any of the officers of the assessee company and it was not necessary for the assessee company to protect its officers who might have acted in an illegal or improper manner. It has been also submitted by him that the assessee company was mainly interested in protecting one of the directors of the company against whom allegations were levelled. In fact, the Commission was to find out whether the concerned officers or the director had committed any wrong and therefore the assessee company could have watched the proceedings by rendering necessary assistance to the Commission through its officers and therefore the expenditure so incurred was absolutely not necessary for its business. Moreover, it has been submitted by him that the said expenditure had not been incurred for the purpose of earning profits. Thus, he has submitted that the Assessing Officer and the Tribunal had rightly disallowed the expenditure. He has also relied upon some judgments to substantiate his submissions. The judgments cited by him have already been referred to hereinabove and therefore we do not think it necessary to enumerate the same again.

16. We have herad the learned advocates at length. After hearing them and upon perusal of the law laid down by the Supreme Court and other High Courts in the judgments cited by the learned advocates it is very clear that in each case, where one has to see whether the expenditure incurred by the assessee is allowable as business expenditure, one has to see whether the expenditure was in reality a business expenditure which was incurred for earning profits or was incurred as a measure of business expediency or for protecting or safeguarding assets of the business including goodwill of the business. Moreover, if the expenditure is such that it is incurred in connection with some activity or transaction which is directly and substantially connected with the running of the business of the assessee and if it pertains to the business itself, it should be considered as business expenditure. In all such cases it must be shown that the expenditure was laid out wholly

and exclusively for the business.

17. It is not in dispute that the officers and the director of the assessee company, against whom allegations had been levelled, had also engaged their advocates to represent their respective cases before the Commission. As the allegations were levelled against the officers and the director, they were very much interested to see that their cases were represented effectively and they were not held guilty of the charges levelled against them. In view of the said fact, one might think that it was not necessary for the assessee company to engage its own advocate. The function of the assessee company was only to render necessary assistance to the Commission. The Tribunal has observed that some of the officers could have rendered assistance to the Commission by placing on record relevant material which was required by the Commission to find out whether the so-called erring officers and the director were in fact guilty. The stand of the assessee company is that it was also the duty of the assessee to render necessary assistance to the Commission so that the Commission can come to the right conclusion. According to the learned advocate appearing for the assessee company, it was also necessary for the assessee company to know whether the officers and the director of the assessee company had acted in an improper manner. If, ultimately, it was found that some officers had acted in an improper or dishonest manner, the assessee company was very much interested in taking action against the guilty officers. Moreover, the assessee company also wanted to see that if the officers and the director concerned had acted in a proper and prudent manner so as to increase profits of the assessee company, the concerned officers and the director were not stigmatized. If such a thing happened, morale of the staff of the assessee company would have been adversely affected. It becomes the duty of the employer to see that its rightful employee is always protected. The assessee company was also interested in protecting its goodwill or business reputation. If, in fact, the officers had acted in good faith and if they were not sufficiently protected, and if any adverse observations were made by the Commission, such remarks would have not only tarnished reputation of the assessee company but would have also adversely affected business of the assessee. So as to render real assistance to the Commission, according to the assessee company, it was necessary to place all facts before the Commission with help of an able advocate and by merely showing the record of the company, through its officers, purpose of the assessee company was not likely to be served.

18. It is also pertinent to note that the assessee company is a subsidiary of a government company which had lot many dealings with the State of Gujarat and was also dealing in essential commodities. If, on account of improper assistance to the Commission, correct facts were not placed before the Commission, and if in absence of complete and correct facts, the Commission had come to some incorrect conclusion against the assessee company or its officers or its director, the reputation of the assessee would have been adversely affected. Moreover, for the purpose of protecting its reputation and its straight forward officers, the assessee had to engage an advocate to assist the Commission. Though it is not very much relevant, it is worth noting that ultimately it was found by the Commission that the officers and the concerned director had acted in good faith. It was thus finally found that the assessee company was not having dishonest or unscrupulous officers and the dealings of the assessee company were just and proper. Had there been any stricture or adverse remarks against the officers or the director of the assessee company, in the eyes of the public at large the assessee company would have been treated as an unscrupulous business unit of the State of Gujarat.

19. In our opinion, looking to the facts of the case, the assessee company was justified in engaging an advocate. Purpose of the assessee company was not likely to be served by mere production of required record before the Commission. The Commission was also required to be properly assisted by putting several relevant facts before the Commission in its proper perspective so that upon appreciation of all the relevant facts and circumstances of the case, the Commission can come to a right conclusion.

20. Thus, for the purpose of protection of the business goodwill of the assessee and to ascertain whether the officers and the director of the company had acted in a proper manner, the expenditure incurred by the assessee company for engaging an advocate should be treated as business expenditure and, therefore, it should be allowed as business expenditure under the provisions of sec. 37(1) of the Act. Looking to the circumstances in which the advocate was engaged, it cannot be said that the expenditure incurred was not wholly and exclusively for the purpose of business of the assessee.

21. Very often one has to leave it to a shrewd

businessman as to whether he should make a particular type of expenditure for enhancing his business or for the purpose of protecting his business reputation. One cannot have a straightjacket formula to ascertain whether a particular expenditure can be said to be business expenditure. Very often there is a situation in business that only a shrewd businessman can decide whether he should make a particular type of expenditure so as to increase his profits or to enhance his business reputation or to reduce his business losses. One has to look at the expenditure from a practical point of view. It has been observed by Chagla, J. (as he then was) in case of Aruna Mills Ltd. v. CIT, 31 ITR 153, that

> ".....What the Income-tax Act purports to tax is business profits, and business profits are the true profits of a business as ascertained according to commercial principles. There may be an expenditure or there may be a loss which may not be an admissible loss under any of the provisions of sec. 10(2) and yet such an expenditure or loss would have to be allowed in order to determine what were the true profits of a business, and it is the duty of everyone who has anything to do with taxing business-people to understand what are the principles of commercial expediency. Unless one understands these principles it is difficult to make a proper assessment on a business or on a businessman."

22. In our opinion, it was for the assessee to decide how to protect its own interest. It was for the assessee to decide how it should be represented before the Commission. It is surely not open to the revenue to prescribe the manner in which the assessee should get itself represented before the Commission to show that its officers and the director had not committed any illegality or irregularity in the conduct of the business of the assessee and that the concerned persons had acted in the manner in which the assessee should have done its business. Normally, one would presume that every businessman knows his interest best and he would do his best to do his business so as to earn maximum profits and there is no reason to believe that the assessee in the instant case acted in a manner which would not befit a shrewd businessman while taking a decision regarding the way in which it should represent its case before the Commission. In reality, the expenditure was incurred for the purpose of protecting or safeguarding goodwill of the

business which is an important business asset of the assessee and, therefore, as stated hereinabove and as held in the case of CIT v. H. Hirjee (supra), we are of the view that the expenditure incurred by the assessee for engaging an advocate is an expenditure allowable under the provisions of sec. 37(1) of the Act.

23. In the circumstances, we answer the question referred to us in the affirmative, that is, in favour of the assessee and against the revenue. The reference stands disposed of with no order as to costs.

(D.M. Dharmadhikari, C.J.)

(A.R. Dave, J.)

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